

**Stephen M. Ross School of Business  
University of Michigan**

**Fall 2006**

**BE580: COMPETITIVE TACTICS**

**Professor Thomas P. Lyon**

**Section 002: MW 12:40-2:10pm (K1310)**

**Section 451: W 7:00-10:00pm (E1540)**

**CONTACT INFORMATION:**

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**COURSE DESCRIPTION:**

This course focuses on two main questions: How can firms develop and maintain profits in the face of competition, and how do governments use antitrust and competition laws to set limits on the degree to which firms exercise market power? The objectives of this course are to understand the effects of firm tactics and strategies on the firm's customers and rivals, and their likely reactions, and to see how policies designed to promote competition affect the feasibility of various actions firms might want to take. In particular, we will compare the U.S. and European approaches to competition policy and the implications for business. We will apply the analytical tools of economics and basic game theory in our examination of firm decisions and industry competition. The dimensions of competitive strategy that we cover include product differentiation, horizontal mergers, strategies to deter entry, predatory practices, strategic commitment, cooperative pricing, and vertical restraints. The concepts in the course will be developed using a mix of lectures, business cases, and antitrust case material.

**PREREQUISITE:**

BE502 or permission of the instructor.

**COURSE MATERIALS:**

Text (required): Besanko, Dranove, Shanley, and Schaefer, *Economics of Strategy*, 4<sup>th</sup> edition, John Wiley and Sons, Inc. 2006.

Course Materials (required): Readings & Cases

**COURSE REQUIREMENTS AND EVALUATION:**

Participation.....	10%	
Midterm .....	25%	October 18
Team Project .....	30%	Due December 11
Final .....	35%	Exam Week

**Accommodation for Disability**

If you think you need an accommodation for a disability, please let me know by September 13. Some aspects of the course, the assignments, and the in-class activities may be modified to facilitate your participation and progress. As soon as you make me aware of your needs, we can work with the Office of Services for Students with Disabilities to help us determine appropriate accommodations. I will treat information you provide as private and confidential.

**Team Project: Structure, Conduct and Tactics**

For the final project in this course, you will work in a team of 4-5 students to study an industry, and a particular company within that industry whose tactics intrigue you. You will be free to select the firm, though I will impose some limits on how many teams can study the same firm. Of particular interest are tactics that help a firm attain or maintain a dominant position within its industry. As it says on the Federal Trade Commission website (“Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws”): “While it is not illegal to have a monopoly position in a market, the antitrust laws make it unlawful to maintain or attempt to create a monopoly through tactics that either unreasonably exclude firms from the market or significantly impair their ability to compete.” The types of tactics that come under scrutiny include predatory (below-cost) pricing, price discrimination, tying, and exclusive dealing arrangements. Competition agencies (like the Department of Justice in the U.S. or the European Commission in the EU) are growing increasingly concerned about the variety of tactics used by dominant firms to maintain or increase market share. The authorities in the EU in particular seem to be growing increasingly wary of dominant firms and are putting more restrictions on how they compete. You are by no means required to select a firm that faces antitrust issues, but you may find the project more fun if you do.

Your final paper should have the following three sections:

**Section 1 – Industry Structure:** What is the industry you are studying, and who are the firms in it? (Note that although this question is being asked in a business strategy context, it is the same as the “market definition” problem faced in antitrust cases.) What are the underlying, relatively stable, aspects of the industry? For example, what is the elasticity of demand, and how is the market segmented? What is the structure of costs in this industry? Mostly fixed? Variable? Sunk? Are there significant economies of scale and scope? Is the underlying science and technology developing rapidly or slowly?

**Section 2 – Industry Conduct:** What are the customary practices or ways of doing business in the industry? Are products in the industry similar, or is there substantial product differentiation? What type of price structures do firms charge, e.g. do they use multi-part tariffs or quantity discounts? Is price competition intense or muted? How important is innovation? What types of sales outlets do firms use---specialized retail stores, large discount stores, online sales?

**Section 3 – Competitive Tactics:** Describe the specific tactics of your focus firm in more detail. From the firm’s point of view, and thinking about the economics of the relevant market, *how would these tactics raise profits?* (Think about the direct effect and the strategic effect.) Might these tactics potentially run afoul of the antitrust laws? Why?

The write-up is limited to 10 pages maximum, and it should be divided into the three sections outlined above. It must be typed using 12 pt. font, with 1.5 line spacing and 1-inch margins. (Note that this limits you to

approximately 3000 words of text.) The first two sections should be relatively short (up to 5 pages for both sections combined); the emphasis of the paper is on the last section. Tables and charts can be attached at the end of the paper and do not count toward the page limit. Be sure to footnote any facts that you use in your paper, giving a full citation to the documents you use. If the documents you use are available on the web, please provide the web address in the footnote. Otherwise, please be prepared to turn in a hardcopy of your reference documents if I request them.

This assignment will be graded based on the accuracy of your analysis and the clarity of your explanations. Although you should feel free to use bullet points to organize your thoughts, I expect you to use full sentences (not sentence fragments) in your write-up.

	<b>Concepts</b>	<b>Lecture 1</b>	<b>Lecture 2</b>
1			Market Structure and Competition (Sept 6)
2	<b>Oligopoly</b>	Models of Oligopoly (Sept 11)	Case: RTE Cereals (Sept. 13)
3	<b>Mergers and Antitrust in the US and EU</b>	Case: Staples vs. Office Depot (Sept 18)	Case: GE/Honeywell (Sept 20)
4	<b>Strategic Commitment</b>	Case: Coors (Sept 25)	Case: Philips' CD (Sept 27)
5	<b>Dynamics of Pricing Rivalry</b>	Case: Beauregard Textile (Oct 2)	Models of Dynamic Pricing (Oct 4)
6	<b>Pricing Rivalry and Antitrust</b>	Case: GE/Westinghouse (Oct 9)	Facilitating Practices and the Antitrust Law of Cartels (Oct 11)
7		No Class: Study for Midterm Exam (Oct 16)	<b>MIDTERM EXAM (Oct 18)</b>
8		<b>No Class – MBA Forums (Oct 23)</b>	<b>No Class – MBA Forums (Oct 25)</b>
9	<b>Entry and Exit</b>	Case: Dogfight Over Europe (A) (Oct 30)	Case: Coffee Wars (Nov 1)
10	<b>Entry Deterrence</b>	Case: DuPont in TiO <sub>2</sub> (Nov 6)	Case: Walkenhorst Chemical (Nov 8)
11	<b>Sustaining Competitive Advantage</b>	Case: Innovation and Imitation (Nov 13)	Networks and Positive Feedback (Nov 15)
12	<b>Network Industries</b>	Case: Palm Computing <b>Evening class meets</b> (Nov 20)	<b>No Class</b> (Nov 22)
13	<b>Exclusionary Conduct</b>	Exclusionary Conduct (Nov 27)	Case: Kodak (Nov 29)
14	<b>Tying and Bundling</b>	Tying and Bundling (Dec 4)	Case: Microsoft (Dec 6)
15		<b>Review</b> (Dec 11)	No Class (Dec 13)
16	EXAM WEEK		

## DETAILED LIST OF TOPICS WITH READINGS

(Text is abbreviated *BDS*)

### MODULE 1: OVERVIEW OF OLIGOPOLY

This course focuses on two main questions: How can firms develop and maintain profits in the face of competition, and how does the government use antitrust policy to set limits on how firms exercise market power and increase profits? In order to answer the first question, we need to study how firms compete. Answering the second question requires a general knowledge of antitrust laws. This first module provides a basic overview of competition in markets with small numbers of firms, what economists call “oligopolies.” We focus on how market structure (e.g. economies of scale, elasticity of demand) shapes competition, how mergers affect market structure, and how price competition operates in concentrated markets. This will put us in a position to study the emergence of market dominance in Module 2 after the midterm.

#### Week 1: Economics Review and Antitrust Overview

This course focuses on two main questions: How can firms develop and maintain profits in the face of competition, and how does the government use antitrust policy to set limits on how firms exercise market power and increase profits? In order to answer the first question, we need to study how firms compete. This requires a review of basic cost, demand, competition, and monopoly concepts. Answering the second question requires a general knowledge of antitrust laws. We begin here with an antitrust overview and then we will return throughout the course to study how different business practices are treated in the antitrust laws.

Reading: BDS, pp. 9-40 (Primer: Economic Concepts for Strategy)  
 “Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws”  
 (U.S. Federal Trade Commission website)

#### Week 2: Market Structure and Competition

This week we lay the groundwork for the analysis to follow. We begin by looking at economic models of competition in markets with a limited number of players. Why are there only a few firms in the market? The most straightforward answer is that there are barriers to entry. That is our first topic for discussion. Then, accepting that there are markets with only a few competitors (at least for a significant period of time), we begin our discussion of how these firms compete. We look at two cases: homogeneous product competition (Bertrand and Cournot models) and differentiated product competition (location models).

##### Barriers to Entry

Reading: BDS, Ch. 2

##### Homogeneous Product Competition: Cournot & Bertrand Models

Reading: BDS, Ch. 6, pp. 209-215

**Differentiated Products Competition: Strategic Positioning**

Reading: BDS, Ch. 6, pp. 216-217

Case: “The Ready-to-Eat Breakfast Cereal Industry in 1994 (A)” (Harvard Business School)

**Week 3: Merger Review**

Horizontal mergers (i.e., mergers between competitors) have the goal of reducing costs and/or increasing market power. Mergers that involve firms above a certain size threshold must be reviewed by the government’s antitrust authority. Although the threshold and manner of review vary across countries, most countries have some sort of merger review process. In many cases the government simply approves the merger; in most other cases the government requires the divestiture of assets; finally, in a few cases, the government blocks the merger. Governments with active merger review programs can therefore control (to some extent) the number of firms in the market, potentially altering the market structure if they intervene in the merger.

**Essentials of Merger Analysis & U.S. Merger Review**

Reading: BDS, Ch. 6, pp. 191-198 and Ch. 10

Carl Shapiro, “Mergers with Differentiated Products,” speech to the American Bar Association, November 9, 1995.

U.S. Department of Justice and Federal Trade Commission “Horizontal Merger Guidelines” (*available at* <http://www.usdoj.gov/atr/public/guidelines/hmg.pdf>)

“U.S. v. Oracle Corporation: Three Lessons to Be Learned About Merger Review” (*Antitrust Quarterly*, Issue 7, Q3 and Q4, pp. 1-4; *available at* <http://www.mayerbrown.com/antitrust/publications/article.asp?id=2001&nid=112>)

Excerpt from “Concentration Ratios in Manufacturing, 1997” (U.S. Census Bureau, 1997 Economic Census; *full report available at* <http://www.census.gov/prod/ec97/m31s-cr.pdf>)

Case: “FTC v. Staples Inc. and Office Depot Inc.”

**Multi-jurisdictional Merger Review**

Reading: “A Comparison of Horizontal Merger Guidelines in Canada, the European Union, and the United States” (Brian Facey and Henry Huser, *Antitrust*, Fall 2004, pp. 43-50)

“The Anatomy of the GE Honeywell Disaster” (Michael Elliott, *Time* online edition, July, 2001; *available at* <http://www.time.com/time/business/article/0,8599,166732,00.html>)

Case: “Antitrust Investigations in a Global Setting: The EU Investigation of the GE/Honeywell Merger” (Harvard Business School 9-204-081)

**Week 4: Strategic Commitment and First-Mover Advantage**

We normally think it's good to "keep our options open," but often there is great power in limiting our future options. First movers in an industry have the opportunity to shape the market in which their rivals must compete. But does a first-mover advantage always exist? And when it does, just how does a firm take advantage of it? These are the themes we explore this week.

**Reading for this week:** BDS, Ch. 7

Cases: "Adolph Coors in the Brewing Industry" (Harvard Business School 9-388-014)  
 "Philips' Compact Disc Introduction (B)" (Harvard Business School)

**Week 5: Cooperative Pricing: Trying *Not* to Compete**

As we all know, a monopolist will earn higher profits in the long run than a firm in a perfectly competitive industry. In oligopolistic markets, profits can either be low or high, depending on a variety of factors. One of those factors is the competitive or cooperative behavior of the firms. If the firms can agree – either tacitly or explicitly – not to compete over such things as price and advertising, then they can get closer to the monopoly or joint-profit maximizing outcome. Explicit agreements to fix price or quantity are illegal in most countries. Tacit collusion, however, is usually legal. What mechanisms can be used to help an industry achieve a more cooperative equilibrium?

**Reading for this section:** BDS, Ch. 8

**Dynamics of Pricing Rivalry**

Case: "Beauregard Textile Company" (Harvard Business School)

**Week 6: Dynamic Pricing Rivalry and the Antitrust Laws****Sustainability of Cooperative Pricing**

Case: "GE versus Westinghouse in Large Turbine Generators" (B) and (C) (Harvard Business School) (Case (C) will be passed out in class.)

**Anti-Cartel Laws in Today's Global Marketplace**

Reading: "Cartels: Fixing for a Fight" (*The Economist*, April 20, 2002, pp. 63-64)

**Week 7: Midterm****Week 8: Break for MBA Forums**

## MODULE II: ESTABLISHING AND MAINTAINING DOMINANCE

There are a number of competitive tactics that first movers in an industry can use in order to gain an advantage. These same tactics are sometimes used by firms already dominant in an industry who find an opportunity to take actions to maintain that dominance. Each of the topics below could fit into either category, i.e., influencing the number of players in an industry by leveraging a first-mover advantage (if it truly exists) and/or reacting to competitive threats in an attempt to maintain market power. Each of these strategies has potential benefits, but there are a host of risks and uncertainties, primarily associated with anticipating the full economic cost of pursuing these strategies and anticipating competitor reactions. In addition, antitrust laws prohibit some of these strategies as “abusive” or “exclusionary” business practices by firms having a dominant position in the market. We will start our discussion with the relatively familiar strategy of predatory pricing, and then move to an analysis of price discrimination and tying, strategic preemption (requiring an understanding of strategic commitment), limit pricing, excess capacity, and raising rivals’ costs.

### Week 9: Entry and Exit

Reading: BDS, Chapter 9.

Cases: “Dogfight Over Europe: Ryanair (A)”  
 “Strategic Behavior and Attempted Monopolization: The Coffee (General Foods) Case”

### Week 10: Entry Deterrence

Reading: BDS, Chapter 9.

“A Framework for Entry Deterrence Strategy” (Thomas Gruca and D. Sudharshan, *Journal of Marketing*, July 1995, pp. 44-55)

“Playing by the Rules: How Intel Avoids Antitrust Litigation” (David B. Yoffie and Mary Kwak, *Harvard Business Review*, June 2001, pp. 119-122)

Cases: “Strategic Capacity Preemption: DuPont (Titanium Dioxide) (1980)” (Ch. 6 of *The Antitrust Revolution*, 2<sup>nd</sup> ed., Oxford: Oxford University Press (1994), John E. Kwoka and Lawrence J. White, eds.)

“Walkenhorst Chemical”

### Week 11: Sustaining Competitive Advantage

Reading: BDS, Chapter 12.

“Networks and Positive Feedback”

Case: “Innovation and Imitation”

### Week 12: Network Industries

Case: “The Rise and Fall (?) of Palm Computing in Handheld Operating Systems”

**MODULE III: VERTICAL RESTRAINTS**

Up to this point in the course we have been focusing on horizontal competition, i.e., competition between firms in the same stage of the supply chain. Now we turn to vertical issues, focusing on a variety of price and non-price vertical restraints. These price and non-price restraints are treated differently under the law, which can make it a particularly difficult area for business to navigate, especially for dominant firms.

**Week 13: Exclusionary Conduct**

Reading: “When Exclusivity Means Illegality” (Ellen Byron and Teri Agins, *Wall Street Journal*, Jan. 6, 2005, p. A11)

Case: “Links between Markets and Aftermarkets: Kodak (1997)” (Case 17 of *The Antitrust Revolution*, 4<sup>th</sup> ed., Oxford: Oxford University Press (2004), John E. Kwoka and Lawrence J. White, eds.)

**Week 14: Tying and Bundling**

Case: “Maintenance of Monopoly: U.S. v. Microsoft (2001)” (Case 19 of *The Antitrust Revolution*, 4<sup>th</sup> ed., Oxford: Oxford University Press (2004), John E. Kwoka and Lawrence J. White, eds.)

**Week 15: Review**